The Biggest Gasoline Retailer Is...
Petroleum Demand Increases, Imports Rise
Strategic Petroleum Reserve: Will it Work?

NPN
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How Giant Shattered Old Truck Stop Image

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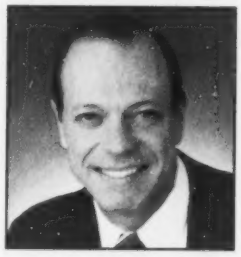

Editor's Viewpoint

Mergers, acquisitions and joint ventures aren't exactly new to the oil industry. Lately, however, there's a new wrinkle. Much of this activity involves foreign oil producers buying or buying into American firms, mainly second tier oil companies and big independents (See related item on page 12). It's a development that's worth watching because of the effect it may have on product supply, pricing and profit margins.

The underlying motive for these deals is that the domestic companies lock into an assured source of supply and the foreign oil producers get American outlets for their product. A rough idea of what may be in store in the U.S. is what is already underway across the Atlantic, where Kuwait is setting the pace. This Middle East producer has purchased a number of refineries on the continent and operates more than 4,500 stations throughout parts of Western Europe and Scandinavia under its (believe it not) "Q-8" brand. It is now reported to be the number two gasoline marketer in Great Britain, second only to Shell. Other oil producing countries may follow its lead.

Meanwhile, back in the States, some industry observers expect Venezuela to expand the beachhead it's established here and think Kuwait and possibly Saudia Arabia are waiting for an opportunity to make their move. The latter two have been listed among the parties interested in working out a joint venture with Texaco, and Kuwait long ago bid for Atlantic Richfield's East Coast operations and Gulf's retail outlets in the Southeast. If these countries make inroads in the U.S. market, others would get the same idea.

What these foreign producers want is the "vertical integration" characteristic of large multinational oil companies, whereby product is controlled from wellhead to gasoline station—with profits generated each step of the way. In fact, downstream profits needn't be very large, or even exist at all, for that matter. The key feature of vertical integration, of course, is that refined product can just about be given away at the retail level because once suppliers have established assured purchasers downstream they can run a lot of crude through their refineries, and it's in the sale of crude to the refineries where the really big money is made. Moreover, once oil producers become involved in downstream operations, they'll be less prone to cut production to keep prices high.

If this scenario begins to unfold, marketers may need to make adjustments because street prices will probably be pushed down sharply and profit margins could get very thin.

—Frank M. Victoria

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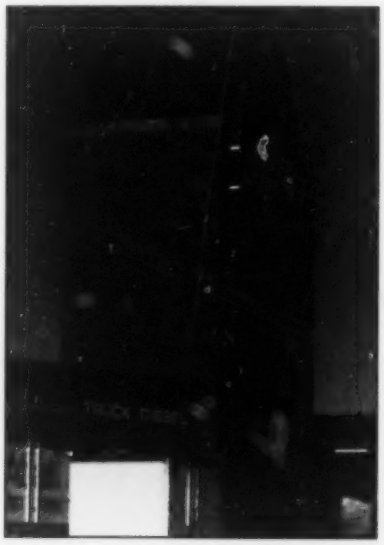

Bigger and better are just two of the adjectives used to describe Giant Industries' new travel center/truck stop in New Mexico. Featured are a 29,000 sq. ft. enclosed shopping mall, 18 full-service diesel lanes and an adjacent company-owned refinery. **Page 32**

The Strategic Petroleum Reserve is designed as a hedge against future supply disruptions. But experts are divided on how the SPR will work in a crisis. **Page 40**

Southland sells more gasoline (retail and wholesale), but has a refinery. Cumberland Farms sells more branded retail product and Getty is coming on strong. So, who's the biggest "independent" retailer?
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• TRENDS

Joint Ventures: Are They Becoming '88 Hallmarks?

The way the winds are blowing, this is as good a time as any to suggest that 1988 may already be shaping up as one that could see a number of U.S. marketers taking foreign oil companies as their domestic partners in joint ventures that would replace the ugly acquisition set-tos of the past.

Such joint ventures aren't everyone's piece of cake, however. They're mostly interesting to the second-tier U.S. oil companies and bigger independents who want to lock up supply sources. But there are exceptions and they serve useful purposes for both American marketers and their foreign counterparts. They also raise a lot of questions about the impact they ultimately will have on domestic supplies and product prices.

Two companies broke the downstream joint-venture ice in 1987—Citgo Petroleum of Dallas, Texas, and Steuart Petroleum of Washington, D.C. Their circumstances are as similar as they are different.

Citgo is a wholly owned subsidiary of Southland Corp., which has a big refinery in the Southwest. It's 50-50 deal with Petroleos de Venezuela gave Southland a solid source of crude at a partnership cost that cannot help but result in some very good product prices. At the same time, it gave Venezuela a home for some of its crude, of which it—like other OPEC lands—have too much of these days. It also gave the Latin Americans a toehold penetration in the domestic marketplace, which has become increasingly important to all oil exporters.

In about the same way, Steuart Petroleum, another independent, made a 50-50 deal with Italy's AGIP last summer. This gave Steuart an infusion of cash for market expansion and an assured source of product. Steuart does not have a refinery, although at various times in the past it has tried to get one. But here again, the Italian partnership deal cannot help but result in some mighty fine street prices for Steuart.

Not long ago, Coastal Corp. (which is based in Houston and sells gasoline and other products on the East Coast, South, Southwest and the Midcontinent/Rocky Mountain areas as well) let it be known that it would also willingly talk to some foreign crude producers and perhaps lock up a supply source for part of its 325,000 b/d refinery capacity. The way Coastal looks at it, according to one source: "You're giving up half the profits but you're getting a solid source of supply. The producer is getting what he wants—an entry into the U.S. marketplace—and so are we."

Texaco is another company that has indicated it would be interested in joint ventures once it gets out of bankruptcy. It's very big company, one of the nation's largest. Texaco has some king-sized problems too. It has refineries and reserves and production of its own but the $6-billion-plus cost of extricating itself from Chapter 11 bankruptcy is going to crimp its exploration ambitions for years to come. So what could be better than a joint venture? Not only would it give Texaco some much needed cash but also a means of hanging on in the direst of circumstances. Texaco has many overseas sources of supply now but its marketplace operations are totally its own. A co-ownership concession is something that may not be totally indigestible if it is a means of staying alive.

There seems to be no lack of foreign oil countries ready, willing and able to talk to American marketers about U.S. partnerships. Kuwait, for example, has already penetrated Western Europe where it owns and operates refineries and service stations alike. It has long been interested in the U.S. Others with niches in oil-importing countries include Libya, Iran and the United Emirates. Saudi Arabia is anxious to go both ways—crude or product. It has some new refineries on stream now that are perfectly capable of doing the job. All it wants to do is get its foot in the door. Nigeria is another exporter which now is making no bones about its downstream interests in U.S. marketplaces.

In short, it seems the marketplace out there is just waiting for something to happen. —*J. Richard Shaner*

• MARKETPLACE AT A GLANCE

AVERAGE GASOLINE PRICES IN THE U.S. (per gal.)

DECEMBER	Gasoline (All types)	Leaded Regular	Unleaded Regular	Unleaded Premium
U.S. City Avg.	$0.975	$0.912	$0.961	$1.119
Regions				
Northeast	1.015	.993	.979	1.149
North Central	.982	.933	.976	1.112
South	.971	.897	.955	1.109
West	.947	.903	.940	1.102

Source: U.S. Dept. of Labor, Bureau of Labor Statistics

STOCKS (add 000 bbl.)

	1/29/88	1/30/87
Gasoline (Total)	235,553	251,358
Gasoline (Unleaded)*	141,387	140,540
Jet Kerosine	39,435	41,835
Distillates	125,604	142,036
Residual	45,063	42,081

** Included in gasoline total.*
Source: American Petroleum Institute.

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Petroleum Demand Increases, Imports Fill Supply 'Gap'

In 1987, U.S. crude oil production was down, product demand was up and imports continued to climb. In other words, it was a rerun of 1986, a period when the domestic industry began absorbing the impact of the crude oil price collapse.

There's good news and bad news, and perhaps some ominous portents, in the American Petroleum Institute's final statistical summary for the year. While demand was up, crude oil production fell to the lowest level in a decade in 1987, API's report says. And, the growing gap between domestic supply and demand is being filled almost entirely by imported products.

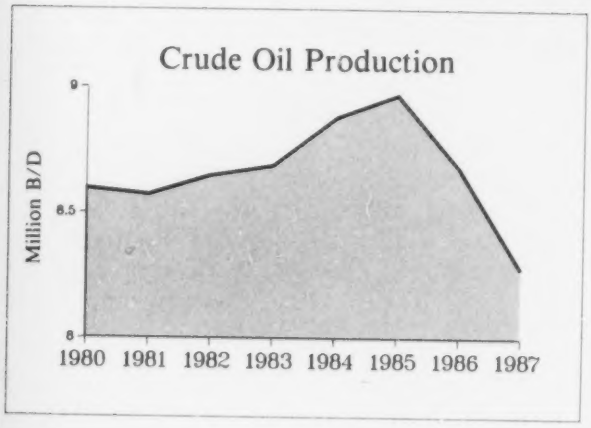
Last year, U.S. crude production averaged 8,288,000 b/d, the smallest figure since 1977 when 8,245,000 b/d were produced. That production level was down 4.5% from the 8,680,00 b/d produced in 1986. API also noted that "by year-end, production was down more than 900,000 b/d or 10% from early 1986."

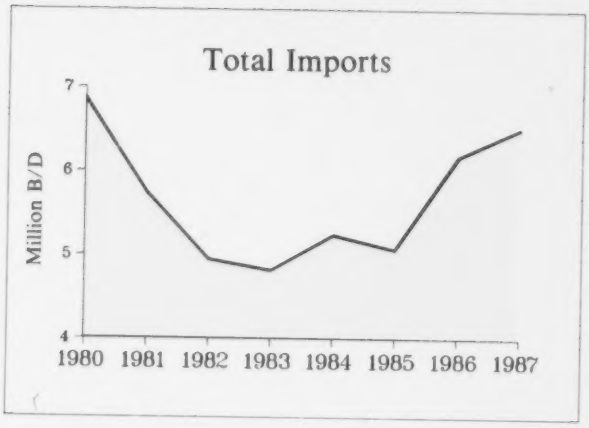
Petroleum product deliveries continued to increase in 1987, reaching an average level of 16,568,000 b/d or 1.8% better than the figure for 1986. The biggest percentage increase in deliveries was in kerosine jet fuel which was up 4.3% for the year. Other major products were up too, except for residual fuel oil, which declined 11.6%.

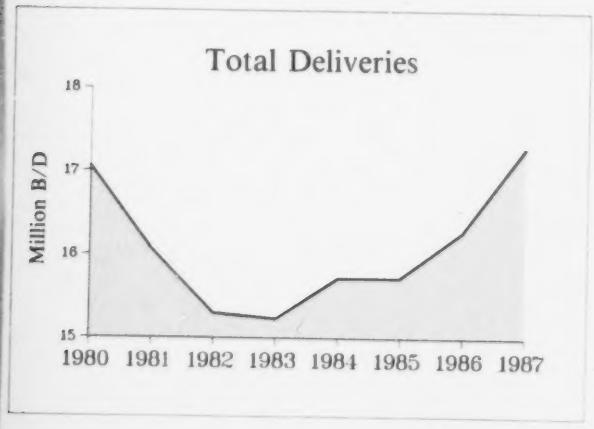
Deliveries of gasoline were up 2% in 1987 with all of the increase in unleaded fuel, which now accounts for almost 80% of the gasoline market, API says. Unleaded gained 6.8% in market share last year, with virtually all of the boost in mid-grade unleaded. The growth rate in gasoline deliveries was slowed somewhat from the year-ago figure (from 3% to 2% increases) despite an estimated 4% increase in miles traveled. API surmises the slower growth was due to improved vehicle fuel efficiency.

(Continued on Page 24)

U.S. SUPPLY AND DEMAND: A 7-YEAR OVERVIEW







Source: 1980-86, Department of Energy – 1987, API

Petroleum Demand Continued . . .

Reflecting higher crude costs for the year, gasoline prices at the end of 1987 were 13¢ a gal. higher than a year earlier, although the average for the entire year was only 2¢ above 1986.

Total imports (crude plus refined product) increased 5.3% in 1987 to an estimated 6,505,000 b/d, the highest level since 1980. Says API, "Imports in 1987 accounted for nearly 40% of deliveries, and almost half came from OPEC producers." Imports have increased a total of 31% or about 1.5-million b/d over the past two years.

Other API year-end data:

- In a companion report on drilling activity, API says that oil well completions for 1987 were down 14.8% to 15,778. Exploratory oil well completions, another benchmark for upstream activity, declined 8.3% from 1986 to 899. Although there was some improvement in 1987 in exploration, development and field maintenance overall, API's data, which had showed a $30-billion, 38% decline in upstream activities in 1986, says that such activities were still well below late 1985 figures—40% below in rig activity, for example and 20% below in field maintenance.
- Refinery capacity stabilized in 1987 and utilization rates have steadily improved from less than 70% in the early 1980s to an annual average of 83% in the past two years.

1987 Supply-Demand

	Million b/d	% Change
Total Domestic Deliveries	16.6	1.8
Gasoline	7.2	2.0
Crude Oil Production	8.2	(4.5)
Total Imports	6.5	5.3

Source: American Petroleum Institute December Monthly Statistic Report

More Spending Planned For Production in '88

Independent and major oil companies worldwide expect crude oil prices to average about $18.20 a bbl. this year, and, therefore budgeting large increases for exploration and production, according to a survey of 207 companies.

The survey, conducted by Salomon Brothers' Stock Research Department, found that for most of the companies even if crude prices fell to $15 a bbl. there would be no change in planned expenditures as long as the price recovered again by midyear.

The survey results may indicate particularly good news on the domestic front. Of the 116 U.S. companies surveyed—19 majors and 97 independents—the majors are budgeting an average increase of 12.4%, or $13.7-billion, for exploration and production. The indies, meanwhile, are budgeting a 19.9% or $2.9-billion increase.

In fact, the survey shows that 64% of the U.S. companies described the economics of exploration as either good or excellent.

Likewise, 41 Canadian companies are budgeting exploration and development increases of 20.6% ($2.9-billion) and 50 international companies are budgeting increases of 16.5% ($14.8-billion). Further, of all the companies surveyed, half are planning to spend a larger portion of their upstream budgets on exploration drilling than last year. The survey notes that the trend has been to spend on development drilling instead.

Perhaps in a reaction to the oil price collapse of 1986, a greater concern for replacing reserve stocks is seen in the survey results, especially among the major oil companies. Reserve replacement was mentioned as a major factor influencing budgets by 31% of the majors and 14% of the independents.

A full 75% of all the companies in the survey feel that the economics of drilling for reserves are more favorable than purchasing them. Although it may not be news to the depressed economies of the U.S. Oil Patch states, the trend among major oil companies is to shift their exploration and production expenditures outside the U.S. where the economics of exploration are seen as more favorable (See chart below).

EXPLORATION ECONOMICS—U.S. vs. FOREIGN

	Majors	Independents
How are the economics of U.S. exploration?		
Excellent	0%	18%
Good	56	48
Fair	28	19
Poor	16	15
How are the economics of foreign exploration?		
Excellent	11%	18%
Good	67	70
Fair	17	6
Poor	5	6

MAJOR OIL COMPANIES— U.S. EXPLORATION/PRODUCTION EXPENDITURES

(in millions of dollars)

	1988*	1987*	% Chng.
Amerada Hess	$ 175	$ 135	29.6%
Amoco	1,550	1,350	14.8
Atlantic Richfield	1,050	925	13.0
BHP	175	150	16.6
British Petroleum	1,150	950	21.0
Chevron	1,100	1,050	4.7
Du Pont	735	590	24.0
Exxon	1,350	1,125	20.0
Mobil	1,110	1,080	2.7
Occidental Petroleum	235	180	30.5
Pennzoil	120	120	—
Phillips Petroleum	250	150	66.0
Shell Oil	1,665	1,520	9.5
Sun	535	510	4.9
Tenneco	265	235	12.7
Texaco	800	720	11.1
Union Pacific	300	185	62.0
Unocal	430	410	4.8
USX Corp.	700	700	—

*Salomon Brothers Inc. estimates
Source: Salomon Brothers Inc.

Upstream Gains Offset by Lower Downstream Margins

In a year of gradual improvement in crude profits accompanied by generally lower product nets, oil companies fared reasonably well in 1987. One indication of this rosier picture: At least six reported net incomes in excess of $1-billion, up four from 1986.

Texaco, beset by legal suits, Chapter 11 bankruptcy proceedings and more running problems than any oil company deserves, had one of its worst financial years in history. It weighed in with a fourth-quarter loss of $4.8-billion and a year-end slump of $4.4-billion. This, despite the fact that it had downstream profits of $69-million in the fourth quarter and $825-million in all of 1987.

Nevertheless, said Texaco in almost MacArthurian style, "we shall return." Said President and CEO James W. Kinnear: "We are looking forward to a year of strengthening Texaco's competitive position. We are planning an aggressive restructuring upon our emergence from Chapter 11. These plans are moving forward now and will accelerate once the burden of the Pennzoil litigation and Chapter 11 has been lifted."

Shell sales of motor fuel rose 5% in the fourth quarter and 8% for the full year, probably a harbinger that it is still the nation's No. 1 gasoline retailer.

The six companies that topped the $1-billion mark in 1987 earnings were: Exxon (the perennial leader), Mobil, Chevron, Shell, Amoco and Arco. In 1985, only two made the billionaire's club—Exxon and Mobil. Earnings of the other companies, while substantial, reflected the collapse of 1986 prices and profits.

Percentage relationships, even though they are standard financial barometers, are often very deceptive. For example, Exxon had only a meager increase—5.1%—in its fourth-quarter profits. But 5.1% of $1.6-billion equates out to a lot more cash-in-hand ($78-million) than 75% of $100-million which, while more exotic percentage-wise, is only worth $75-million. Mobil had an exciting fourth quarter, up 92%, but like Exxon, was on the downside for the full year.

Shell had a record increase of 78% in the fourth quarter and 39% for the year. Amoco was up 129% in the final quarter and 82% for 1987. Arco scored increases of 431% and 99% in the same periods. Marathon, which only reports pre-tax operating profits, had a substantial showing in 1987—an increase of 510%.

Details in table at right.

Strong Fourth Quarters Helped Most Companies

Fourth Quarter and Full Year Earnings—1987

(Millions of dollars)

	4th Qtr. 1987	4th Qtr. 1986	% Chng.	Full Year 1987	Full Year 1986	% Chng.
Exxon	$1,556.0	$1,480.0	5.1%	$4,841.0	$5,360.0	(9.7%)
Mobil	389.0	203.0	91.6	1,264.0	1,407.0	(10.2)
Texaco	(4,762.0)	50.0	—	(4,407.0)	725.0	—
Chevron	220.0	(86.0)	—	1,007.0	715.0	40.8
Shell	436.0	254.0	71.7	1,230.0	883.0	39.3
Amoco	377.0	165.0	128.5	1,360.0	747.0	82.1
Arco	340.0	64.0	431.3	1,224.0	615.0	99.0
Tenneco	NA	NA	—	NA	NA	—
BP-America*	NA	NA	—	NA	NA	—
Conoco**	82.0	24.0	241.7	277.0	355.0	(20.9)
Phillips	33.0	11.0	200.0	35.0	28.0	25.0
Sun	83.0	70.0	18.6	348.0	385.0	(9.6)
Unocal	29.8	49.2	(39.4)	181.4	175.8	3.2
Marathon**	(13.0)	81.0	—	445.0	73.0	510.0
Coastal	35.0	66.9	(47.7)	113.1	71.6	58.0
Amerada Hess	(79.6)	78.1	—	229.9	(182.6)	—
Ashland	71.2	27.2	161.8	(1st Qtr., fiscal ends 9/30)		
Diamond Shamrock	3.3	(16.8)	—	1.6	(64.8)	—
Pennzoil	22.0	46.5	(52.7)	44.3	45.4	(2.4)
Kerr-McGee	NA	NA	—	NA	NA	—
Murphy	(61.0)	(207.0)	—	(43.0)	(194.8)	—
Amer. Petrofina	13.6	5.0	172.0	83.3	(24.6)	—
Citgo	NA	NA		NA	NA	—
Getty	NA	NA		NA	NA	—
Cumberland	NA	NA		NA	NA	—

*Formerly The Standard Oil Co.; **Conoco and Marathon are pre-tax operating profits.

Downstream: The Year-End Nets Were Negative

(Millions of dollars)

	4th Qtr. 1987	4th Qtr. 1986	% Chng.	Full Year 1987	Full Year 1986	% Chng.
Exxon (Total)	$376.0	$305.0	2.3%	$491.0	$1,934.0	(74.6%)
Domestic	82.0	15.0	446.7	32.0	478.0	(93.3)
Foreign	294.0	290.0	1.4	459.0	1,456.0	(68.5)
Mobil (Total)	(27.0)	259.0	—	206.0	1,299.0	(78.8)
Domestic	53.0	65.0	(18.5)	123.0	365.0	(66.3)
Foreign	(80.0)	194.0	—	83.0	934.0	(91.1)
Texaco (Total)	69.0	(10.0)	—	124.0	825.0	(85.0)
Domestic	(5.0)	(66.0)	—	(68.0)	128.0	—
Foreign	74.0	56.0	32.1	192.0	697.0	(72.4)
Chevron (Total)	159.0	(46.0)	—	157.0	689.0	(77.2)
Domestic	115.0	(128.0)	—	100.0	209.0	(52.1)
Foreign	44.0	174.0	(74.7)	57.0	480.0	(88.1)
Shell (Total)	93.0	35.0	165.7	224.0	319.0	(29.8)
Amoco (Total)	69.0	37.0	(86.5)	216.0	362.0	(40.3)
Arco (Total)	50.0	48.0	4.2	150.0	353.0	(57.5)
Conoco (Total)	73.0	65.0	12.3	177.0	414.0	(57.2)
Phillips (Total)	64.0	75.0	(14.7)	201.0	458.0	(56.1)
Sun (Total)	23.0	1.0	2,200.0	64.0	214.0	(74.8)
Domestic	22.0	(7.0)	—	46.0	201.0	(77.1)
Foreign	1.0	8.0	(87.5)	18.0	13.0	38.5
Amerada Hess	(195.0)	37.0	—	(79.6)	78.1	—